

## **MBB comments to the European Commission public consultation on the upcoming Revision of the Energy Tax Directive**

**October 2020**

In March 2020, the European Commission published an inception impact assessment outlining the main motivations to revise the Energy Tax Directive 2003/96/EC (ETD). Subsequently, a public consultation was open to all stakeholders to provide feedback ahead of the publishing of a legislative proposal that is expected by June 2021.

The revision of the ETD is considered to have substantial impact on sectors of international importance such as the aviation and maritime sectors. In the case of Malta this will have a wide-ranging negative impact on the economy in general: an increase in transport costs translates into higher expense for the carriage of goods and people in and out of Malta.

The MBB acknowledges that the revision of certain aspects of the ETD are required to reflect technological developments that took place in nearly two decades since its introduction in 2003, such as to account for new products that currently fall outside the scope of the Directive. However, while fine-tuning where required is welcome, the revision should not automatically align to objectives of other policy areas that would result, as highlighted in this paper, in changes to longstanding principles put in place to reflect international norms and the competitiveness of European operators.

### **Background**

The European Commission is proposing a revision of the Energy Tax Directive in the context of the European Green Deal that has the overall objective of making the European Union climate-neutral by 2050. The Commission estimates that transport emissions account to a quarter of the EU's greenhouse gases, and the sector would collectively require to undertake a 90% emission reduction. In the medium term, the European Commission has established a 55% and beyond overall emission reduction target by 2030.

One means to achieve this, according to the Commission, would be to align the taxation of energy products and eliminate the exemptions and reductions of fossil fuel taxes that are currently applicable to the aviation and maritime sectors. The Commission draws a difference between the applicability of taxation to other modes of transport, such as land transport, and argues that this constitutes a fragmentation of the single market and distorts the playing-field across these sectors.

## **The Maltese perspective**

Malta is a small open island-economy, and its geographical location imposes a permanent connectivity handicap with the European mainland. The Maltese economy is dependent on the import and export of supplies for the livelihood of its residents as well as the viability of its manufacturing sector. Furthermore, tourism and its ancillary supply chain provide a predominant contribution to the island's gross domestic product, calculated to be just under 30%. For natural reasons, the only means of transport to and from Malta is by air and sea. This reality is not only applicable to Malta, but also to all other EU island states and regions, and thus any negative impact on communities in these locations due to higher costs would also impact the social cohesion in Europe.

## **The current economic context**

The aviation and maritime sectors are two of the hardest hit sectors by the current COVID-19 crisis. They are strategic and indispensable for the provision of essential supplies but even more so during this and any pandemic. The international economy is navigating through a deep crisis that pushes the balance sheet of operators into the red, with consequential impact on investment and employment. There is also no clear forecast on the recovery of economic activity to pre-crisis levels. Certainly, the timing to start a legislative process aiming to increase the financial burden through taxation on operators and ultimately on consumers, is not aligned with the real economy. It is research and development and innovation rather than taxation that is required for the further greening of aviation and shipping in order to achieve and develop new viable technologies and fuels that have to be available in sufficient quantities worldwide.

The COVID-19 crisis has highlighted the extent of the exposure and vulnerability of these two sectors to external shocks, which is why exemptions from fossil fuel taxation were granted way back in the first place. From a financial perspective, typically, jet fuel accounts for one quarter of an airline's total operating expenses. Thus, with many European carriers struggling to remain operational due to the COVID-19 pandemic, imposing a tax on such a critical input would have severe negative financial consequences for the industry.

## **International competitiveness**

The aviation and maritime sectors are global sectors that require global solutions. Otherwise, regional measures will put European operators in a competitive disadvantage. This was a principle that was wisely adhered to by the Commission in 2011 in the first attempt to revise the ETD, when international awareness on climate action was already ripe, yet the exemptions for aviation and maritime transport were not under question, because of the accepted notion of the competitive distortion they create. The arguments remain valid today, and particularly in the current economic context as pointed out above.

The introduction of a European energy tax on these modes of transport risks carbon leakage and can be circumvented in a way that would limit the emission reduction impact aspired by the EU to meet its climate objectives. International operators could design their fueling and bunkering patterns in a way that by-pass EU jurisdictions and thus continue to benefit from cheaper non-taxed fuels from jurisdictions on the EU doorstep. The Middle East, North Africa, and the United Kingdom as a third country as from next January, all stand to benefit in this process by establishing themselves as hubs servicing the European continent.

In the case of the maritime sector specifically, the introduction of tax on ships' fuel would go against the 1999 Kyoto Convention on the Simplification and Harmonisation of Customs Procedures that stipulates that ships on international voyages shall be entitled to take on board fuel and lubricants exempt from duties and taxes. The current ETD in fact, provides the basis to conform with this global norm.

Similarly, just as there is a mandatory exemption afforded to aviation jet fuel used in commercial air transport by means of Article 14 of the ETD, it is important to note that exempting jet fuel, lubricants, spare parts, technical supplies, and other related items from national fees, duties, taxes and charges is an established principle as espoused by the International Civil Aviation Organization (ICAO), a specialized agency of the United Nations. In this respect, it is important to further note that the EU-US Open Skies Agreement exempts fuel used in international air transport. Consequently, any amendment to the ETD, and Article 14 in particular, that would reduce the scope of the current tax exemption or remove it altogether, would not only be directly counter to international standards and policies, but would significantly disadvantage European-based airlines relative to carriers based outside the EU, where the latter would benefit from an exemption from tax on fuel used in the provision of all international air transport services.

### **Aviation and maritime are already heavily taxed**

The aviation and maritime sectors already contribute substantially in the form of taxation to national economies.

On the aviation side, airlines are faced with a proliferation of taxes, direct or indirect, notably the UK Air Passenger Duty, the French Aviation Eco-Tax and the German Aviation Tax.

On their part, as intrinsically global industries, shipping and maritime operators are affected by a complexity of parameters that should not be undermined. The large number of components of a European and global network that constitute the industry pay a huge amount of corporate taxes. In addition, ships pay tonnage taxes, fees as well as port dues payable at every port of call, even when anchored outside the port area, together with other levies such as infrastructural dues payable at some ports.

The possible introduction of ETS poses a big competitive threat. So does the contemplated removal of exemption of tax on bunkers, also disguised as environmental tax, that could have a

severe negative impact on the ship bunkering industry in Europe particularly in central and north Mediterranean ports. Both initiatives provide no real positive impact on the environment. Not only that, but they could have a severe negative effect on short sea shipping sending back the transportation of cargoes to land motorways severely impacting the concept of motorways of the sea that has had been so positive for environmentally friendly movement of cargo.

### **The transport sectors' commitment to cleaner operations**

Investment undertaken in the aviation and maritime sectors is very costly and return on investment is spread over a long number of years. In this regard, the sectors already make substantial commitments to gradually upgrade respective fleets that use more sophisticated and latest environmentally friendly technologies.

Thus, for instance, Malta's national airline, Air Malta, is undergoing a fleet replacement project whereby it is replacing its Airbus A320s with Airbus A320 neos. Other measures are being implemented from an operational point of view. Moreover, intra-EU flights are currently subject to the EU Emissions Trading System. Further carbon pricing is achieved through the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA), adopted by ICAO, which applies to all international flights. Rather than removing the fuel tax exemptions afforded by the ETD, the airline industry looks forward to the introduction of incentives for sustainable alternative aviation fuels as these would bring about a meaningful reduction in emissions, ultimately the aim of the European Green Deal.

Also, the firm engagement of the maritime industry, particularly shipowners, to the new IMO 0.5% global sulphurcap on fuel content from 1 January 2020, lowering from the 3.5% limit is already on its own a tangible clear commitment to cleaner operations.

It is important to note that fuel costs are by far the largest component of operating costs. There is thus every incentive for ship operators to endeavour to reduce fuel consumption thus rendering their vessels more competitive and attractive for charterers. Yet, however, the available alternative technologies are not far reaching especially for ocean going vessels. This is why the international shipping industry has put forward a proposal to the International Maritime Organisation for an International Maritime Research Fund financed by the industry in the first place via a levy per ton of fuel consumed annually per vessel.

Moreover, the shipping sector is voluntarily engaged in costly RDI initiatives to reduce emissions. It is an operational requirement undertaken hand in hand with a responsible approach towards greener shipping.

For example, during the oil crisis, ships slowed down, and many shipowners invested in additional equipment/materials to improve the energy efficiency of their vessels. Some examples include the usage of advanced low friction antifouling paints, propeller reblading/replacement, bulbous

bow retrofits, installation of additional appendages before and after the propeller, installation of shaft generators and installation of variable frequency drives in large motors.

In more recent years a great deal of research and development has gone towards for example wind propulsion (sails/kites, flettner rotors etc), use of biofuels or natural gas for combustion, design improvements (better bow and stern design, propeller ducts), scheduling optimization and use of batteries.

Other initiatives include the ever-expanding provision of cold ironing facilities in ports. Ships at berth will be able to turn off their diesel engines and run on shore-based electricity all onboard services such as safety, ventilation, air conditioning, ballast systems. This contributes extensively towards a more environmentally friendly shipping and maritime services, provided of course, that shore electricity is produced from renewable energy sources.

### **Tax disguise**

There are concerns that this tax on energy is being disguised as an environmental tax, when ultimately it would be just another source of income for the respective member states. Like the case of tax on harmful health products such as cigarettes, of which there is no empirical evidence showing that revenue is invested to reduce smoking, there is equally no established mechanism to ensure that that revenues from an energy tax on the aviation and maritime sectors would be re-invested in RDI or addressing EU climate objectives.

### **Choice of legal basis**

In the inception impact assessment, the European Commission deliberates on the choice of legal basis, arguing that the revision of the ETD shall focus on environmental issues, and thus outlining the possibility of adopting Article 192 TFEU as a legal basis, which would require an Ordinary Legislative Procedure, instead of Article 113 TFEU that would constitute a Special Legislative Procedure with a unanimous vote in Council as it would normally be in the case of provisions for the harmonisation of legislation concerning excise duties.

An Ordinary Legislative Procedure would require a Qualified Majority in Council, which for small and peripheral EU states, would mean losing full sovereignty on tax matters, even if in the case of Malta this would have huge repercussions on the economy.

Smaller countries are awarded a smaller share of the vote in Council based on the size of their population according to the Treaties, but this criteria is not representative of the size and importance of the relevant sectors impacted by this Directive and their strategic importance to their respective economy.

Furthermore, the Commission has already set a precedent when rightly opting for Article 113 as a legal basis in its first attempt to revise the ETD in 2011.

## **Conclusion**

The MBB reiterates that the aviation and maritime sectors have a strategic role to drive survival, sustainability and international economic growth and, from the perspective of a small peripheral EU island-state, albeit not only, it is crucial that operators continue providing services at a price that is competitive and affordable.

The MBB notes that these sectors already contribute taxes in different forms to national systems and should not be overloaded further, particularly at this time of international economic crisis, and especially when there is a clear risk of carbon leakage due to no means to avoid circumvention with the presence of tax free hubs already established on the EU borders.

The aviation and maritime sectors continue to acknowledge their important role in reducing greenhouse gas emissions, and that it is not taxation the best way to achieve this but through RDI and enabling the right conditions for private investment.

A tax on energy may result in a revenue generation exercise for member states without any stipulated guarantee that this would be re-invested to meet EU climate objectives.

Finally, the choice of legal basis should be consistent with established precedent in 2011 and with any tax related legislation, i.e. Article 113 TFEU requiring a special legislative procedure in Council.

**The Malta Business Bureau is the EU advocacy organization of the Malta Chamber of Commerce, Enterprise and Industry, and the Malta Hotels and Restaurants Association. The MBB is also a partner of the Enterprise Europe Network.**